Urban Infrastructure Finance: Implementing Market-based Financing Options

Proceedings

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Sponsored by USAID Indonesia

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URBAN INFRASTRUCTURE FINANCE:
IMPLEMENTING MARKET-BASED FINANCING OPTIONS

PROCEEDINGS

1.0 Conference Background and Objectives

Asia's ability to maintain high economic growth rates and to halt environmental degradation in cities will depend in large part on the ability of local government service agencies to access sufficient capital to finance infrastructure expansion. For example, the population of Metropolitan Jakarta, the conference's host city, is projected to increase to over 35 million in the next 20 years. In the long run, 60 percent of Indonesia's population will live in urban areas. Citizens of these urban areas will have high expectations for economic productivity and quality of life. To respond to this enormous demand for infrastructure, new financing mechanisms must be identified because central government budget allocations, long the financing source for most urban infrastructure, and donor financing are limited, if not declining. The World Bank has estimated that US$1.5 trillion will be needed over the next decade to finance infrastructure in the APEC economies, of which US$80 to US$100 billion will be for water and sanitation. The private capital market is of particular interest since the massive investment requirements exceed public sector sources of finance.

Recognizing the urgent need to develop new resources to finance the enormous demand for urban infrastructure in Asia, and the need for a new decisionmaking framework for government officials, the Regional Housing and Urban Development Office for Southeast Asia organized a regional conference to explore implementation strategies for developing market-based financing options. Fifty-five participants representing public and private sector service agencies, private financial services, and central and local governments met from November 10 to 12, 1996, in Jakarta. Rather than serving as a forum for reviewing the theories or merits of financing approaches, the workshop allowed a pragmatic discussion among policy makers and practitioners of specific implementation strategies for market-oriented options: what is necessary to build investor interest through institutional and regulatory reform and strengthen the capacity of local government urban services agencies.

The conference included discussions on municipal bond markets, municipal development funds, and private sector participation/commercialization in infrastructure development. Case studies from the region provided concrete examples of how these financing options have been approached. They also demonstrated the fast pace at which financing innovations are being introduced in the Region. Participants discussed the role of government and donors in making all three financing options available to local service delivery agencies in an integrated way.

These proceedings provide a summary of the conference sessions. The conference program and list of participants are included as Annexes A and B, respectively.

2.0 Selecting among financing options

The respective roles of central government and local urban services-agencies in establishing and implementing financing choices are quite distinct. While the central government is responsible for creating an environment in which a menu of financing options is available, the specific decision regarding the choice and mix of the options to be used is made at the *local* agency level. Given an expanding menu of options, local service agencies must choose carefully based on an analysis of financial costs and benefits.

Capital Finance for Municipal Infrastructure: Choices Viewed by the Enterprise and the Investor, Dr. Ronald Johnson, Research Triangle Institute

In light of economic and demographic conditions in Asia, the number one issue for urban services providers is their rate of growth. Not growing fast enough will mean that potential customers are delayed in getting service, opportunities for economic expansion may be lost, and service managers may be viewed as failures and replaced. On the other hand, growing too fast may mean that the service agency is unable to meet its debt service requirements or unable to devote adequate resources to operations and maintenance.

To determine an optimum rate, the service agency needs to be able to assess the cost of alternative financing sources: retained earnings, public or private debt, equity investment, and contributed capital (intergovernmental grants). The service agency must determine what is its sustainable growth rate. This rate is a function of its current profit percentage or retained earnings rate, interest and dividend payments, access to debt, and access to equity. These factors, expressed as return on capital, debt to equity ratio, and interest on debt, permit the service agency to determine a specific growth rate that is sustainable under current conditions. -The service agency must ask itself if it has achieved its sustainable growth rate and if not, what it can do to reach it. Key performance indicators can indicate to a service agency whether its financing strategy should favor debt or equity investment. For most emerging public services, financial leverage generally favors debt. However, if private equity investment brings with it new technologies or management improvements that increase efficiencies, the higher cost of capital for equity investment may be offset by greater efficiency and higher profitability.

Of course, capital market conditions may constrain the ability of service managers to make an open choice between debt and equity sources of financing. Typical constraints include lack of long term debt instruments, limited interest of underwriting services for all but the largest and most visible projects; lack of price benchmarks and secondary markets for municipal debt; lack of credit history on the part of potential borrowers and inability to rate credit worthiness; and, lack of capital market experience in municipal infrastructure projects. Therefore, to facilitate local service agency access to capital for growth, it is incumbent on governments to ensure that a menu of financing options is available to local service agencies. The menu of options can be facilitated through regulatory reform, application of market principals to government lending operations, and capacity building to improve credit worthiness and expand the pipeline of well prepared infrastructure projects.

Discussion

Following Dr. Johnson's presentation there were several points raised about the availability of all financing options and the use of specific indicators in the selection process. The participants agreed that not all options would be available, for different reasons. In some cases, changes in service provision entities and the creation of more autonomous agencies opens up the range of options. In other cases, interest rate distortions caused by subsidies would necessarily make debt a more attractive option than under normal market conditions.

Several participants questioned if this model and the types of indicators that are used in decision making could be applied to all services, fearing that poorly functioning services, typically in poor areas, would be excluded from access to capital for service expansion. Here, the real need is to build capacity and improve local service agency performance so that market-oriented financing options might eventually become more accessible.. It was pointed out that governments should set up market-oriented indicators for performance and then create assistance programs and other incentives to raise performance to that level. The Philippines Municipal Development Fund decision to change its policy of lending so that it lends only to poorer municipalities, leaving stronger municipalities to direct capital market access, was cited as an example of a market-oriented incentive program.

3.0 Implementing Financing Options

Through case study presentations and discussions in plenary sessions and small groups, the participants came to the following conclusions about strategies to stimulate the municipal bond market, strengthen the performance of municipal development funds, and facilitate private sector equity investment in urban infrastructure.

3.1 Municipal Bonds

A well functioning municipal bond financing system is characterized by investor demand built on adequate information about risk, the ability to trade bonds in a secondary market, and security against default. On the supply side, local government issuers require tolerable borrowing costs (competitive interest rates and reasonable issuance costs) and long term amortization periods. These characteristics are made possible by the presence of a number of functions at the investor level, the borrower level, and at an intermediary level in which a variety of services and agencies help build a sound and trustworthy relationship between investors and issuers.

For example, at the borrower level, a sound financial position and financial management practices, full disclosure of financial information, well prepared projects, and clear and accepted capital investment plans enhance the ability of the borrower to gain favorable terms on the bond market. At the intermediate level, services such as credit enhancement mechanisms, underwriter services, regulatory oversight, and legal and financial advisory services contribute to building investor confidence.

Developing a bond market and the institutional and regulatory framework that governs it takes investor and issuer time, which translates into a variety of costs. Furthermore, in the early stages of bond market development, an investor community unfamiliar with municipal debt is likely to demand rates that are higher than those in a more mature market. Higher rates in turn may discourage bond issuers.

The case studies demonstrated that revenue producing activities by local service agencies are probably the best starting point for bond issuance. However, successful implementation of municipal bonds has been thwarted by an encumbering regulatory environment in the case of Ahmedabad and crowding out by concessionary loans in Naga City.

Ahmedabad Municipal Corporation, India

The city of Ahmedabad has undergone a profound change in its management since 1994. A more rigorous management approach has dramatically raised revenues and controlled expenditures providing the city with sufficient margin to look toward the capital market as a source for financing infrastructure improvements. The bond approach is an innovation in India as there had been little experience with it previously. The city has used an Indian rating agency, CRISIL, to provide a credit rating as a mechanism to build investor confidence. In spite of efforts to build popular support among citizens for the initiative and build investor awareness of the city's strengths, approval by state government-level authorities does not seem to be forthcoming.

Naga City, Philippines

The Naga City case represents a different facet of problems in developing a municipal bond market. The Philippines has long had a well functioning capital market, including bonds, and experience with government treasury debt provides a yield curve for municipal issues. Furthermore, the Local Government Code contains provisions regarding intercepts and debt limits that build investor confidence in local government's ability to re-pay bonds and loans. Naga City put together a financing package for a bus terminal that included issues in several denominations (to attract a variety of investors). In addition, the bonds were strongly backed with project revenues, general revenues, and a mortgage. Principal problems in issuing the bonds included the high cost to the issuer (interest rate, underwriter fees) and the lack of institutional experience (financial advisors, for example). In the end, the bonds were never sold because a more attractive loan of multilateral donor funds channeled through a government financing intermediary was made available to the city. Current policy developments to facilitate bonds as an infrastructure finance mechanism include the possibilities of a tax exemption on bond interest, measures to prevent government intermediaries from lending to municipalities that can access capital at market rates, and strengthening credit enhancements such as intercepts of intergovernmental revenues.

Discussion

After these presentations, several participants raised questions about the donor role in infrastructure finance. The Naga City case study demonstrated how the objectives of some donor programs to strengthen one financial intermediary may conflict with a broader objective of establishing market-based financing systems. Participants suggested that in the interest of establishing sustainable financing systems, donors should avoid projects that would tend to crowd out market-based financing mechanisms.

The case studies also provoked considerable discussion about the value of a tax exemption on interest from municipal bonds as a mechanism to encourage their use. Some specialists argue that loans should be made to the end user at market rates and policy should avoid the distortions caused by subsidies. On the other hand, some participants suggested that treasury losses from an exemption would be more than counterbalanced by the additional resources mobilized from new investments that would, in the end, provide more income to the government. They felt that the urgent need to develop infrastructure financing mechanisms justifies the subsidy.

Finally, participants commented on the problem of over-securitization that typifies an emerging bond market. To reassure potential investors, issuing service agencies must pledge a high level of revenue and assets to secure their first bonds. However, this decreases their debt capacity over the longer term because much of their resource base is tied up as security for the first issue.

A major conclusion reached by the participants was that efforts to stimulate bond market development should target three sets of actors: issuers, investors, and the intermediate service providers such as underwriters, credit enhancements agencies and companies, rating agencies, and regulatory oversight agencies that help build confidence between issuer and investor. There are diverse factors that have constrained the development of bond markets to the present. Capital markets are insufficiently developed and yield curves for long-term public securities frequently do not exist. The investment community, including intermediary institutions, generally has little experience with municipal bonds which results in difficulty in getting issues to market (lack of advisors for example) and higher cost in terms of fees and interest rates when issues are sold. At the same, on the issuer side, there has not been a large pipeline of properly packaged projects that have been brought to market.

Looking into the future, the participants recommended measures, primarily at the policy, intermediary, and issuers levels, to improve the functioning of municipal bond markets. These reforms could well be tested on a pilot project basis. Recommended policy reforms include clarifying the approval process for municipal bonds with a view toward minimizing delays caused by oversight agency review; providing incentives such as tax exemptions to help start the market; and simplifying the regulatory environment. The development of intermediary institutions and services is also vital. Specifically the conference recommended attention to the strengthening of credit rating agencies, establishing credit enhancement mechanisms such as bond insurance or revenue intercepts, and strengthening financial advisory services available to local issuers. At the issuer level, the conference recognized the need for improving the quality of project proposals both in terms of the preparation and presentation of bonds and the basic management capacity of service agencies. Specifically the participants identified the need for improved financial management and accounting systems.

3.2 Municipal development funds (MDF)

Forms of municipal development funds with the primary role of increasing the supply of financing available for urban infrastructure have existed in most countries in the region for some time. They typically have existed as a line item function in the Treasury or Ministry of Finance, funded by annual budgetary allocations and donor assistance. Recognizing the need to dramatically increase the level of lending and improve the efficiency of these operations, many countries in the region are reforming municipal development funds to make them more dynamic elements of an infrastructure financing system.

A number of factors that are internal and external to MDF's are critical to improved performance and expanded capacity. Internal factors include financial and management capacity, marketing and outreach to potential borrowers, and overall financial discipline. External factors on the policy or governmental level include the clarity of the defined role of the MDF (social-versus purely financial goals), level of capitalization, autonomy, and the transparency of central government grant/subsidy programs in relation to MDF lending operations. The management and financing capacity, translating into debt carrying capacity, of local borrowers is another external factor.

The case studies from Indonesia, Nepal, and India demonstrated a common policy intention to reform these funds by providing more autonomous management and to mobilize resources from the capital market for their capital expansion. The participants agreed that the evolution of MDFs toward more market-oriented management by improving internal management procedures and raising interest rates to approach market rates is necessary to make them sustainable institutions.

The Regional Development Account, Indonesia

In Indonesia, the Regional Development Account (RDA) was established in 1991 to provide long term credit to local governments and enterprises and to help them transition to the private capital market by providing debt management experience and creditworthiness. Although its lending has increased significantly in recent years, the RDA has been only a small part of infrastructure financing, dominated by central government budget allocations and donor assistance. The

Government has recognized that intergovernmental grants and donor assistance alone do not establish a sustainable infrastructure financing system and so has moved to expand local government debt financing through the RDA.

The reforms envisaged for the RDA consist of two phases. During the first phase, the RDA will remain under the Ministry of Finance and reforms will target:

> *capitalization*: increasing financing levels from diversified sources and increasing funding certainty by decreasing reliance on government budget allocations;
>
> *loan operations*: conversion to wholesale lending to regional development banks, improved loan processing and closer supervision;
>
> *sustainability*: incremental increase in lending rates to cover full cost of lending and pledging of local government property tax revenues and enterprise receivables to secure loans.

These improvements will lay the foundation, in the second phase, for the transformation of the RDA into a self-standing financial intermediary that will access the private capital market for its future capital needs.

The Town Development Fund Board, Nepal

The Towns Development Fund Board of Nepal was established in 1989 with the objective of providing capital resources to municipalities and strengthening their management capacities. Since its implementation in 1996, the TDFB has combined a grant and a loan program for infrastructure development. Local borrowers must demonstrate past and projected revenue surpluses and present standardized project feasibility studies to qualify for a loan. The loan program differentiates between revenue producing and social infrastructure by providing longer maturities and lower interest rates for social investments. The interest rates for both types of loans are below standard commercial bank rates. The grant program is intended to complement the loan program by assisting poorer municipalities, defined by municipal revenue and per capita income levels.

Since it began operations, the TDFB has encountered problems due to poor municipal capacity in preparing and implementing projects; a loan ceiling that is insufficient for infrastructure needs; difficulty in finding a real competitive base of construction contractors; and a lengthy approval process. In addition, lack of organizational autonomy has led to numerous delays while waiting for ministerial approval.

A decree recently approved by parliament and pending Royal Assent will establish the TDFB as an autonomous corporate institution under banking legislation, capable of accessing the private capital market for its resources. In addition, the TDFB will pursue efforts to improve municipal capacity through training.

The Mumbai Metropolitan Regional Development Authority, India

Recognizing the need for coordinated development planning in the burgeoning Mumbai (formerly Bombay) metropolitan area, the Mumbai Metropolitan Regional Development Authority was established in 1975 to engage in physical planning and development control, project formulation and monitoring, and infrastructure finance. While many of its early efforts focused on the development planning and project design aspects of its mission, more recently the MMRDA has focused on infrastructure finance. With World Bank financing for the Bombay Urban Development Project in 1988, MMRDA created a revolving fund to finance urban projects on a sustainable basis. The fund was capitalized by proceeds from land development schemes. Loan repayments were made on a split basis from the project implementing agencies (45%) and from the Government of the state of Maharashtra (55%). Loan repayment rates for a variety of municipal service and infrastructure projects have been good. However, the experience has also demonstrated difficulties in lending to municipal governments because of the lack of capital investment planning, poor accounting practices, and low acceptance of borrowing as a means of financing infrastructure investments. Nevertheless, the experience has demonstrated the value of expanded mechanisms to meet the significant infrastructure needs in the region.

MMRDA, in collaboration with the federal and state governments and financing institutions, is establishing a financial intermediary for infrastructure development, because municipal governments are not in a position to access directly the capital market. The intermediary will be in the form of a Trust Fund, managed by a private asset management company. Fifty-one percent of the capital will be contributed by financial institutions, 39% by MMRDA, and the governments will contribute 10%. The company will have the necessary financial management and technical capabilities to ensure the financial viability of projects and funds operations, thereby making it creditworthy for direct access to the capital markets. At the same time, the fund will provide services to the local government borrowers and agencies to strengthen their technical and financial capabilities.

Discussion

In discussing past experience with MDFs and future needs for reform, the participants agreed that these institutions can fill a vital niche in market-based financing systems. However, experience to date has shown that they have not operated on market principals, therefore reforms must continue to facilitate changes that provide greater management autonomy, lending at full market cost, and with transparent and efficient internal management procedures. MDFs' ability to access the capital market will depend on how the market perceives their creditworthiness, which~~,~~ in turn~~,~~ depends on these factors.

This evolution also dictates that MDF lending should target certain classes of local service agencies who otherwise would not have access to the capital market. As the richer, generally larger local governments build their own creditworthiness, MDF lending policy should facilitate their graduation to direct capital market access, leaving MDF resources to target less creditworthy local governments. In the region, the Philippines MDF provides a good example of the development of a graduation policy under which loans are made at market rates and grants are made through an MDF window to poorer local governments. In the future the Philippine MDF will continue this policy by providing assistance to poorer local governments while refraining from lending to creditworthy local governments capable of accessing market rate capital.

In this regard, a primary future niche for MDFs is to serve as a pooling mechanism for local governments who are less creditworthy because of their weak revenue base or small relative size of their financing needs. Pooling offers more opportunities for credit enhancement and risk mitigation. One example of a pooling mechanism is a bond bank in which the institution consolidates several municipal issues into a single issue offered by the pooling mechanism (or it may issue a bond in anticipation of several municipal issues). This permits an economy of scale and reduces transaction costs, but requires the pooling mechanism to establish its own creditworthiness. As an alternative, an existing institution may raise capital by securitizing the revenue stream from a group or pool of outstanding loans for a capital market instrument and use the new capital to lend to municipalities. Another alternative is a mechanism that administratively consolidates several municipal issues into one grouped offering. The entity assumes no risk of its own but simply reduces the transaction costs to the municipalities. A final example of a pooling mechanism is a pooled insurance or credit enhancement in which, for example, reserve commitments from bond issuers would be deposited into a fund, in some cases with matched private funds, that serves as a form of bond insurance.

3.3 Private Sector Participation

The definition of privatization/commercialization adopted for the purposes of the seminar was any measure taken to involve the for-profit sector in the construction, operation, and ownership of municipal infrastructure and services. Emphasis was placed on arrangements in which the private sector provides financing for infrastructure investments or in which the private sector assumes some portion of the risk associated with the provision of services, including asset ownership. It is increasingly understood that private sector involvement of these types can yield benefits such as:

- mobilizing capital to meet investment needs without adding to sovereign debt;
- improving the efficiency and quality of urban services;
- increasing access to advanced technologies;
- allocating risks more efficiently.

The promise of infrastructure privatization/commercialization has not been met for a number of reasons including a gap in expectations between public officials and private investors regarding

risk, lack of clarity about government objectives; , insufficient political commitment, lack of an appropriate legal and regulatory framework, lack of procedural transparency, and lack of long term finance mechanisms. Despite these difficulties, drawn from world-wide experience, the uneven pace of privatization/commercialization in Asia has suffered more from a shortage of investment opportunities than from a shortage of financing.
Case studies of private sector participation from the Philippines, India, and Indonesia provided insights into the conditions that make investment opportunities attractive to private investors. Although the examples each involved different services and types of private involvement, they demonstrated similar conclusions.

The Mandaluyong Public Market, Philippines

Faced with the urgent need to rebuild the public market that had been destroyed by a fire , at a cost that exceeded is financial capacity, the city of Mandaluyong (Metro Manila, Philippines) chose to act under the newly passed provisions for BOTs (Build-Operate-Transfer). Initially, the city had difficulty attracting investors. However, with the active leadership of the mayor, a group of investors was assembled to undertake a project, which, after numerous negotiations about the form and respective contributions of the parties, was significantly more complex than the original design. The new design was attractive to the investors who were providing 25% of the capital investment and assuming the risk for all cost overruns. In addition to the 25% equity contribution, the project was financed by advances from shop owners (25%), and by municipal debt (50%).

The project demonstrated the champion and initiator role that the local government must play to move this type of project toward completion. It also demonstrated the flexibility that is required on the part of both public and private actors to achieve a final design that meets the needs of both sides. On the government side, the experience demonstrated the need for the municipality to accept sharing power and losing a degree of control, maintaining continuity in its negotiating team, and providing a supportive, low risk environment for investors. Conversely, private partners must understand the local government’s objectives, negotiating practices, and constraints.

The Tirupur* Area *Development Plan, India

Tirupur, in the state of Tamil Nadu, is one of India's leading knitwear export centers. Recognizing that the financing and operation of an ambitious area development plan to address water supply, wastewater treatment, roads, and telecommunications required to expand the industrial potential of the area was beyond the capacity of a single governmental entity, government and industrial interests have formed a partnership to undertake this innovative development program. One of the principal innovations is the commercial basis of the program: public and private capital financing is recovered by a variety of user charges (water supply and wastewater treatment constitute the initial phase of the program). Creation of acceptable tariff structures has required cross subsidies between industrial and household users. The project has also required strong support from all levels of government, particularly the State of Tamil Nadu, to mobilize public resources and carry out the necessary regulatory reforms such as the ability to charge user fees, allow access to water resources, permit the commercial operation of the program, and attract private investment by subordinating the public debt for the program.

To manage the program, the government has created a special purpose entity, the New Tirupur Area Development Corporation, Ltd. (NTADCL). This mechanism was deemed necessary because of its ability to attract a variety of public and private actors to the program, and to manage relations with the State. Infrastructure Leasing and Financing Services, Ltd (ILFS), has been the principal actor in designing the program and in channeling national and donor loans. Developing a framework for a project of this complexity has required the establishment of many channels for communication and dispute resolution among the partners and has required sensitive management of risk factors. The program apportions risk among public (Tirupur Municipality, State of Tamil Nadu) and private partners (NTADCL, Tirupur Exporters Association, ILFS, BOT operator) in ways that are consistent with their respective roles.

Water Supply in DKI Jakarta, Indonesia

The Government of Indonesia's development plans include a special focus on improving water supply to urban users. Currently, piped water supply is constrained by high levels of unaccounted for water, low pressure, and poor quality. The tariff structure does not provide incentives for users, including large industrial users, to access piped water rather than relying on wells that deplete groundwater resources. However, expanding service coverage and improving service quality will require considerable investment, at a level that is probably beyond the conventional government budgetary allocation. Recognizing the potential for private sector involvement, regulatory reforms of 1994 were designed to attract private investment, including foreign investment, for infrastructure development.

The Jakarta metropolitan government, DKI Jakarta, has entered negotiations to develop concession contracts for the expansion and operation of the regional water utility, PAM Jaya. Private involvement is expected both to improve service performance and attract additional capital for service expansion and up-grading. The government is currently negotiating 25 year service contracts with two private consortia. The contracts are expected to contain performance targets related to volume of water sold, coverage, reductions in non-revenue water, water quality at the tap, and supply maintenance. They will also contain provisions for transfer of existing PAM Jaya staff and regular review of tariffs to ensure the commercial viability and affordability to customers. To date, negotiations have focused on the structure of an escrow account to receive charges and make payments to the investors and the utility; narrowing the definition of force majeure so as to place the burden of operating responsibility on the concessionaires; defining conditions for contract termination; permitting the concessionaire to own the assets until the end of the contract; and clarifying the form of central government support for the project.

Discussion

In drawing conclusions, the participants found that the following conditions facilitate entry of the private sector into service and infrastructure provision:

- regulatory reform to provide a conducive and transparent regulatory environment;
- political stability and political support for privatization/commercialization projects;
- understanding that the generally higher cost of equity investment can be counterbalanced by efficiency gains during project implementation through management improvements and the use of improved technology;
- flexibility must be maintained in project design to allow the private investor to adapt the project so that it is financially viable; and,
- transparent and competitive procurement processes and open negotiations between the parties.

4.0 The Role of Government and Donors

Donor financed infrastructure projects often aim to achieve a variety of objectives, some of which may conflict with the objective of establishing sustainable market-based financing systems. Examples of this potential conflict include:

direct competition for borrowers: donors providing loans directly to local service agencies at rates that are below market rates, thereby preventing the borrower from pursuing a capital market solution.

pressure on MDFs: pressure on donor-supported MDFs to improve loan management and repayment, for example, will cause MDFs to "cherry pick,"; lending at subsidized rates to the strongest municipalities who might otherwise be good candidates for private capital market access.

resistance to reform: by focusing on short term institutional performance rather than longer term system performance, donors may fail to support the policy reforms that are required to develop sustainable, market-based financing systems.

single solution: donors or ministries favoring a single "best" financing mechanism for urban infrastructure projects create competition among agencies, each with their preferred solution at the expense of a more integrated approach.

5.0 Conclusions

In summary, the conference stressed the importance of making available to service delivery agencies a menu of financing options and removing regulatory restraints to their use. At the policy or institutional level, governments and donors must recognize that an integrated package of financing mechanisms offers flexibility and the possibility of meeting the diverse needs of local governments and service agencies as well as the varying requirements of different types of projects. Typically, a service agency may require mixing financing mechanisms. To make the most appropriate mix, service agencies must unbundle the components of a project to match the financing option that is best suited to the respective components. At the same time, the flow of information to investors, should be improved to reduce their perception of risk; and to borrowers, to increase their understanding of financing options.

The central government plays a critical role in creating an integrated system by 1) establishing a supportive, undistorted policy environment and eliminating competing preferences of different central government agencies for one option or another; 2) shifting risk from lower levels to the higher level that can better support the risk; 3) developing targeted financial support for poorer cities; and 4) establishing a policy to help credit worthy local governments graduate to market access.

Donors can play a supportive role for market-oriented options by not crowding out local capital market solutions. Furthermore they can be supportive of the policy and institutional changes that are required for market-based solutions. For example, instead of direct financial support for specific project implementation, donor finance can serve to support the development of capital market institutions and instruments to finance urban infrastructure (such as guarantee or insurance facilities, credit rating services, the conversion of government loan programs to market-based institutions, and the separation of social support from financing mechanisms).

The conference recommended that donors move away from concessionary lending for specific projects to system lending in a way that encourages market-oriented systems to develop. At the same time, host governments need to make a greater effort to coordinate donor financing so that assistance across donors provides support to a common framework. Recognizing the predominant role of local governments in urban service delivery, donors should also be advocates for decentralization by working with multiple governmental levels, particularly the local level, and by supporting capacity building for local governments and the associations that represent them.

Annex A: Conference program

Financing Urban Infrastructure: Implementing Market-Based Financing Options
November 10-12, 1996
Jakarta, Indonesia

Program

Sunday, November 10

	Arrival of the participants
7:00 p.m.	Welcome cocktail, Hotel Radisson

Monday, November 11

8:30 a.m.	Opening ceremonies
	Welcoming comments by the Director of the USAID Mission to Indonesia
	Welcoming comments by the Director of the Urban Management Program for Asia
	Opening Address by the Representative of the Minister of Finance, Government of Indonesia
9:30	Break
9:45	Technical overview session - *Mr. N. von Einsiedel*, moderator
	"Capital Financing for Municipal Infrastructure: Choices as Viewed by the Enterprise and the Investor," *Dr. Ronald Johnson*, Research Triangle Institute
	Plenary discussion
10:30	Municipal bonds - *Ms. Priscilla Phelps*, moderator
	Case study panel
	India: *Mr. D. B. Makwana,* Deputy Municipal Commissioner, Ahmedabad Municipal Corporation and *Ms. Srikumar,* CRIS-India
	Philippines: *Mr. James Leigland,* RHUDO
12:30	Lunch
1:30	Municipal development funds - *Erlito Pardo*, moderator
	Case study panel
	Nepal: *Mr. Hemant Gyawali*, Executive Director, Town Development Fund Board

	Indonesia: *Dr. Susiyati Hirawan*, Head, Bureau for Regional Financial Analysis, Ministry of Finance
	India: *Mr. V.K. Phatak, ,Chief of Planning,* Mumbai Metropolitan Region Development Authority
	Discussion
3:00	Break
3:15	Small groups: Next steps in implementing municipal credit systems - Municipal bond groups - Municipal development fund groups
5:00	Adjourn
7:00	Reception, Home of USAID Director

Tuesday, November 12

8:30 a.m.	Report out of small groups - *Mr. Hal Minis*, moderator
9:15	Privatization - *Dr. Dinesh Mehta*, moderator
	Case Study Panel
	India: *Dr. Ramchand*, Chief of Infrastructure Advisory Services, ILFS and *Mr. V. K. Phatak*, Mumbai Metropolitan Region Development Authority
	Indonesia: *Ir. Achmad Lanti,* Secretary to the Director General of Human Settlements, Ministry of Public Works
	Philippines: *Mr. Jorge Briones*, Executive Director of the BOT Center
	Discussion
12:00	Lunch
1:30	Simultaneous small-group discussions: - Integrating financing options in a financing system - The role of donors in developing infrastructure finance systems
3:00	Break
3:15	Small groups report out
4: 00	Conference conclusions: Panel discussion
4:45	Concluding remarks - *Mr. William Gelman*, RHUDO Director
5:00	Adjourn

Annex B: List of participants

Infrastructure Finance Regional Workshop
November 10-12, 1996
Jakarta, Indonesia
Participant List

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